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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

JAMES A. GORDON, Special Deputy State Insurance Commissioner of Maryland and Receiver for Eastern Indemnity Company of Maryland,

Petitioner,

v.

UNITED STATES DEPARTMENT OF THE TREASURY, *et al.*,

Respondents.

AMICI CURIAE BRIEF OF THE PROPERTY AND CASUALTY INSURANCE GUARANTY CORPORATION, THE ILLINOIS INSURANCE GUARANTY FUND, THE WISCONSIN INSURANCE SECURITY FUND AND JAMES T. ODIORNE IN HIS CAPACITY AS TEXAS ANCILLARY RECEIVER FOR EASTERN INDEMNITY COMPANY OF MARYLAND

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The Amici Curiae respectfully pray that James A. Gordon's petition that a writ of certiorari issue to review the opinion of the United States Court of Appeals for the Fourth Circuit be granted.

CONSENT

Pursuant to United States Supreme Court Rule 36.1, a copy of the written consent of the Parties to the filing of this Amici Curiae Brief on behalf of The Property and

Casualty Insurance Guarantee Corporation, the Illinois Insurance Guaranty Fund, the Wisconsin Insurance Security Fund, and James T. Odiorne in his capacity as Texas Ancillary Receiver for Eastern Indemnity Company of Maryland, is separately enclosed.

STATEMENT OF THE CASE

The Petitioner asks this Court to decide a critical issue under the McCarran-Ferguson Act and to thereby resolve a conflict between:

(1) The Maryland insurer liquidation statute which requires a liquidator to pay claims of policyholders in full prior to paying other creditors' claims (MD. ANN. CODE art. 48A, § 132 *et seq.* (1986)); and

(2) A federal statute first enacted in 1797 which provides that a claim of the United States shall be paid first when a person indebted to the government is insolvent (31 U.S.C.A. § 3713 (West Supp. 1988)).

The McCarran-Ferguson Act, 15 U.S.C.A. § 1011 *et seq.* (West 1976), provides that the business of insurance shall be regulated by the states and that "[n]o Act of Congress shall be construed to invalidate, impair or supersede any [state] law . . . regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." The McCarran-Ferguson Act thus mandates that conflicts be resolved in favor of state laws regulating the "business of insurance" absent specific application of federal law to the insurance business. Nevertheless, the District Court ruled in favor of the general federal priority statute, reasoning that the Maryland statute governing insur-

ance company insolvency and liquidation proceedings was not a law enacted for the purpose of regulating the "business of insurance" as that term is defined under the McCarran-Ferguson Act. The United States Court of Appeals for the Fourth Circuit affirmed the District Court's decision, adopting the lower court's opinion as its own.

STATE INSURANCE GUARANTY ASSOCIATIONS' INTEREST IN THE DISPUTE

All fifty states and the District of Columbia have enacted statutes establishing insurance guaranty associations. An insurance guaranty association is a non-profit association of all of the property and casualty insurers licensed in a particular state. An insurance guaranty association's purpose, subject to certain limitations, is to pay the residents of its state who have claims under insurance policies issued by insolvent insurers that were licensed to do business in that state. Upon paying such claims, a guaranty association receives a claim in the insolvent insurer's liquidation proceedings equal to the amount of the claims paid. If the guaranty association is unable to satisfy its claim against the insolvent insurer's estate (in whole or in part), it assesses its member companies by the amount of the short fall and the member companies, in turn, raise their policyholder's premiums to recoup the cost of this assessment. The federal government's assertion that it has a "super-priority" over the claims of other policyholders and the guaranty associations will, therefore, have a substantial impact, not only on the final resolution of Eastern Indemnity's insolvency, but on the liquidation procedures of all fifty-one U.S. guaranty associations.

If the Fourth Circuit opinion is allowed to stand, the decision will adversely affect state insurance liquidation proceedings and diminish policyholder protection in at least two respects:

First, the federal government's asserted priority will cause policyholders of insolvent companies to suffer a lower priority claim with respect to claims not covered by state guaranty associations. All state guaranty associations place limits on the claim amounts subject to guaranty association protection. Some associations may also not cover certain lines of business (such as surety bonds).[1] Claims in excess of guaranty association limits or claims in excluded lines of business can only be collected from the estate of the insolvent insurer.

Second, all state guaranty associations have annual limits on the maximum assessments that may be levied against member companies to pay covered claims. If the federal "super-priority" is upheld, more of the insolvent insurers obligations will be borne by guaranty associations which, in turn, will lower the capacity of the associations to respond to insolvencies. Moreover, the decision will require insurance policyholders generally to bear the added burden of the federal "super-priority."

The Property and Casualty Insurance Guarantee Corporation (the "Maryland Guaranty Corporation") is the in-

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[1] *See* TEX. REV. CIV. STAT. ANN. art. 21.28-C § 1 (Vernon 1987) (surety bonds excluded from the scope of the Texas Property and Casualty Guaranty Association's protection). Other states, including Illinois, have recently amended their guaranty fund statutes to exclude surety bonds. *See* ILL. ANN. STAT. ch. 73, § 1065.83(c) (Smith-Hurd Supp. 1988).

surance guaranty association created under Maryland law.[2] The Illinois Insurance Guaranty Fund (the "Illinois Fund") is the insurance guaranty association created under Illinois law.[3] The Wisconsin Insurance Security Fund (the "Wisconsin Fund") is the insurance guaranty association created under Wisconsin law.[4] The Maryland Guaranty Corporation and the Illinois fund are two of the eight state insurance guaranty associations that will pay claims under surety bonds issued by Eastern Indemnity.[5] The guaranty associations in the other twenty-six states where Eastern Indemnity was licensed provide no coverage at all for claims under surety bonds. Non-governmental bondholders in those states must collect from the estate of the insolvent insurer, or not at all.

Section 158A of the Maryland Insurance Code, like almost all state insurance liquidation statutes, gives guaranty association claims and policyholder claims that are not covered by guaranty associations equal priority. If the Fourth Circuit's decision is allowed to stand, payment of the government's claim will completely exhaust the Eastern Indemnity estate. There will be no assets left to pay the claims of the eight guaranty associations burdened by Eastern Indemnity's insolvency. Moreover, if the government's "super-priority" is allowed, policyholder claims in the twenty-six states where Eastern Indemnity did business and whose guaranty funds do not cover surety bonds will be rendered worthless.

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[2] MD. ANN. CODE art. 48A, § 504 *et seq.* (1986).

[3] ILL. ANN. STAT. ch. 73, § 1065.82 *et seq.* (Smith-Hurd Supp. 1988).

[4] WIS. STAT. ANN. § 646.01 (West Supp. 1986).

[5] The other guaranty associations that will pay claims under surety bonds issued by Eastern Indemnity are: Georgia, Nevada, Texas, Michigan, Louisiana and the District of Columbia.

Guaranty associations are not operated as state agencies and are not funded by state tax revenues. Instead, guaranty associations assess their member insurance companies for the money needed to pay claims. The assessed companies, in turn, recoup the amount of those assessments by charging their policyholders higher premiums. Section 516 of the Maryland Insurance Code, for example, requires members of the Maryland Guaranty Corporation to include in their premiums amounts sufficient to recoup any assessments by that Guarantee association. Similarly, the Illinois courts have expressly recognized that through their premiums, policyholders of solvent companies pay for the Illinois Fund's coverage of the policyholders of insolvent Illinois insurers. *Adams v. The Illinois Insurance Guaranty Fund*, 85 Ill. App. 3d 867, 869, 407 N.E.2d 638, 640 (1980).

To the extent that guaranty associations recover on their claims against insolvent companies, they return those amounts to their members who, in turn, reduce their policyholder's premiums.[6] Everytime a policyholder pays his or her premium to a licensed, *i.e.*, member, company, part of that premium goes to pay the claims of policyholders of insolvent insurers. Therefore, the less a guaranty association is able to recover from the estate of an insolvent insurer, the greater the burden it must place on the policyholders of its members.

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[6] *See* MD. ANN. CODE art. 48A, § 516 (1986):

> The rates and premiums charged for insurance policies and surety bonds . . . shall include amounts sufficient to recoup . . . a sum equal to the amounts paid to the Corporation by the member insurer *less any amounts returned to the member insurer by the Corporation*. . . .

(emphasis added).

If the decision of the Fourth Circuit Court of Appeals is allowed to stand, there will be no assets left to reimburse the eight guaranty associations burdened by Eastern Indemnity's insolvency, and those guaranty associations will be forced to pass on the cost of the claims they cover to the policyholders of their member insurers.

The long-term effect of that decision will be borne by the insurance buying public and as the primary function of this country's guaranty associations is the protection of the insurance buying public, the Amici guaranty associations have a very real interest in seeking this Court's review of the Circuit Court's decision.[7]

TEXAS ANCILLARY RECEIVER'S INTEREST IN THE DISPUTE

James T. Odiorne is the Texas Ancillary Receiver for Eastern Indemnity. Pursuant to the order appointing him ancillary receiver and pursuant to Article 21.28 of the Texas Insurance Code, Mr. Odiorne has taken possession of certain Eastern Indemnity assets located in the State

[7] *See* MD. ANN. CODE art. 48A, § 504(a)(1) (1986):

> The purposes of this subtitle are to provide a mechanism for the prompt payment of covered claims under certain insurance policies and to avoid financial loss to residents of Maryland who are claimants or policyholders of an insurer, *including surety*, which has become insolvent; and to provide for the assessment of the cost of such payments and protection among insurers.

(emphasis added). *See also* WIS. STAT. ANN. § 646.01(2)(a) (West Supp. 1986). *And see* ILL. ANN. STAT. ch. 73, § 1065.82 (Smith-Hurd Supp. 1988).

of Texas. Mr. Odiorne has the right and duty to use those assets to determine and pay the claims of Eastern Indemnity's Texas policyholders as well as those of the Texas Property and Casualty Insurance Guaranty Association (the "Texas Guaranty Association"). While Mr. Odiorne has the right to use Eastern Indemnity's Texas assets to pay the expenses of the receivership's administration, the Fourth Circuit's decision has effectively exhausted those assets and the costs of the receivership are being covered by the Texas Guaranty Association.

The Fourth Circuit's decision stripped Mr. Odiorne of the assets he was supposed to use to carry out his statutory duty of protecting Texas policyholders. The Circuit Court's holding has left the Texas Ancillary Receiver with insufficient assets to pay the administrative expenses of determining policyholder claims, let alone the assets needed to actually pay those claims. While the Texas Guaranty Fund has "taken up the slack" somewhat, assessing its members to cover the costs of the federal government's asserted claim, the ultimate cost of the Texas Guaranty Fund's rescue will be borne by Texas consumers.

Thus, because of his immediate concern regarding the costs and consequences of Eastern Indemnity's liquidation and his overall concern regarding the potential impact of the Fourth Circuit's decision on future Texas receiverships, the Texas Ancillary receiver has a very real interest in seeking this Court's review of the lower court's decision in this case.

SUMMARY OF ARGUMENT AND REASONS FOR GRANTING THE WRIT

The Maryland Liquidator and these Amici Curiae take the position that the McCarran-Ferguson Act, 15 U.S.C.A. § 1011 *et seq.* (West 1976), both by its express language and its intended purpose, negates the government's "all mine" contention and renders the general provisions of 31 U.S.C.A. § 3713 (West Supp. 1988) inapplicable to this case. The relevant provisions of the McCarran-Ferguson Act are as follows:

> (a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.
>
> (b) *No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance,* or which imposes a fee or tax upon such business, *unless such Act specifically relates to the business of insurance*: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

15 U.S.C.A. § 1012 (West 1976) (emphasis added).

By holding that the liquidation of an insolvent insurance company does not fall within the McCarran-Ferguson Act's definition of the "business of insurance," the Fourth Circuit's opinion does violence to that Act's intent, purpose and express language; is unfair and inequitable to many

of those involved in government construction work; and misconstrues prior decisions of this Court interpreting that Act in its narrow anti-trust context.[8]

Moreover, a decision by this Court on the issue presented is urgently needed now because:

1) Other federal courts have held that the liquidation of an insolvent insurance company constitutes the "business of insurance" for McCarran-Ferguson Act purposes;[9]

2) The Court of Appeals decision will have a direct impact on all ongoing and future insurance company liquidations wherein the federal government is a claimant—leaving state liquidators shackled with the threat of personal liability for incurring expenses that reduce the government's take, even those expenses necessary to marshall all of the insolvent estate's assets;

3) Finally, the Court of Appeals decision threatens more than the liquidation process. The Fourth Circuit's holding that the regulation of such a central aspect of the insurance industry does not constitute the regulation of the "business of insurance" for McCarran-Ferguson Act purposes, calls into question many of the most funda-

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[8] *See* James A. Gordon's Petition for Certiorari in this matter, p.8 n.5 (citing: *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979) and *Securities and Exchange Commission v. National Securities, Inc.*, 393 U.S. 453 (1969)) (hereinafter "Gordon Petition").

[9] *See* Gordon Petition, p.8 n.5 (citing: *Washburn v. Corcoran*, 643 F.Supp. 554 (S.D.N.Y. 1986) and *Idaho ex rel. Soward v. Internal Revenue Service*, 662 F.Supp. 60 (D. Idaho 1987)). Although the latter was recently overturned by the United States Court of Appeals for the Ninth Circuit, that fact merely underscores the need for this Court to review and settle this issue once and for all. *See* 88 Daily Journal D.A.R. 11528 (September 9, 1988).

mental aspects of state insurance regulation and gives the federal government the means to sidestep the McCarran-Ferguson Act in numerous other insurance regulatory contexts. Armed with the Circuit Court's decision, the government will be able to challenge any state insurance law it finds objectionable, establishing in the courts that which to date has been denied by Congress—a federal body of insurance law.

ARGUMENT AND REASONS FOR GRANTING THE WRIT

I.

THIS COURT SHOULD DECIDE WHETHER THE "BUSINESS OF INSURANCE" UNDER THE McCARRAN-FERGUSON ACT IS LIMITED TO THE BUSINESS OF SOLVENT INSURANCE COMPANIES.

The essence of the Fourth Circuit's decision is that the McCarran-Ferguson Act applies only to the regulation of solvent insurance companies. However, neither the McCarran-Ferguson Act itself, common sense, public policy or case law support such a result.

The Maryland Insurance Code's liquidation provisions are part of the overall statutory scheme by which Maryland regulates the business of its insurers. Like every state, Maryland keeps a close watch on its insurance industry—from formation and licensing (MD. ANN. CODE art. 48A, § 42 *et seq.* (1986)) to dealings with policyholders (MD. ANN. CODE art. 48A, §§ 375, 242 (1988)) to the cancellation of policies (MD. ANN. CODE art. 48A, § 240A (1988))

to the rehabilitation and liquidation of insolvent companies, MD. ANN. CODE art. 48A, § 141 (1986).[10]

Subtitle 10 of the Maryland Insurance Code, which governs insolvency and liquidation proceedings against insurers, and section 158A of that subtitle, which gives policyholders priority in the distribution of an insolvent insurer's assets, regulate the "business of insurance" at its most basic and fundamental level, namely paying the claims of policyholders. By governing what this Court has held to be the core of the "business of insurance"—the relationship between an insurer and its policyholders, *Securities and Exchange Commission v. National Securities, Inc.*, 393 U.S. 453, 460 (1969), the Maryland liquidation priority statute regulates the very essence of that state's insurance industry.

The mere fact that a liquidator replaces the board of directors of an insurance company should not alter the basic nature of the insurer/insured relationship. If, it does and the McCarran-Ferguson Act applies only to the regulation of solvent companies, that is a far-reaching decision that only this Court should make.

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[10] *See* WIS. STAT. ANN. § 645.01(4)(f) (West 1980) ("The purpose of this chapter is the protection of the interests of insureds, creditors, and the public generally, . . . through . . . *[r]egulation of the insurance business* . . . .") (emphasis added).

II.

THE COURT OF APPEALS DECISION WILL UNFAIRLY DEPRIVE MANY WHO WORK ON GOVERNMENT PROJECTS OF ANY MEANS OF FINANCIAL PROTECTION.

Like most states, Maryland gives the policyholders of an insolvent insurer a priority over all other claimants (with the exception of the liquidator, certain employees, and state and federal tax authorities). MD. ANN. CODE art. 48A, § 158A (1986). Courts which have interpreted similar provisions in other jurisdictions have recognized that this type of priority protects the interests of the insurance buying public—those who most need protecting when an insurer becomes insolvent. *American Re-Insurance, et al. v. Washburn, et al.*, 122 Ill. 2d 555, 566-68, 524 N.E.2d 538, 542-43 (1988). The Fourth Circuit's decision, however, completely ignored this interest and stripped Eastern Indemnity's non-governmental bondholders of the protection they had contracted for and, in many cases, of their state law lien rights as well.

Maryland's priority statute requires *all* of Eastern Indemnity's policyholders to share pro rata in the liquidated assets of that company in accordance with the cardinal rule of liquidation—no member of a class of creditors shall be allowed a preference over the other members of that same class.[11] By thwarting this distribution scheme, the

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[11] *See People v. Cosmopolitan Insurance Company*, 89 Ill. App. 2d 225, 223 N.E.2d 90 (1987):

> The insolvency of an insurance company casts burdens upon its insureds, claimants against its insureds and, if a stock company, against its stockholders. The consequences to those injured are severe. This court cannot, however, . . . seek to lessen the injury of one . . . at the expense of other injured persons . . . .

(Footnote continued on following page)

Fourth Circuit Court completely negated the equitable purpose of that statute and doomed hundreds of contractors, laborers, and materialmen to receive no payment at all on their claims under Eastern Indemnity's surety bonds.

Moreover, many of the claimants who will be denied recovery from the Eastern Indemnity estate are claimants under Miller Act bonds issued by Eastern Indemnity in connection with federally funded construction projects. One type of Miller Act bond is a performance bond designed to protect the government's interests as the owner of a project.[12] Another type of Miller Act bond is a payment bond designed to protect the interests of laborers and materialmen who perform services or provide goods for the benefit of a government owned project.[13] Denying recovery from the Eastern Indemnity estate under this second type of bond is particularly harsh since, under the Miller Act, these laborers and materialmen will also be denied their normal state law lien rights. Because they have no enforceable rights against the federal government and cannot acquire liens on public property, these laborers' and materialmen's only possible source of protection are the Miller Act payment bonds issued by Eastern Indemnity.[14]

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[11] *continued*

Id., at 93. *See also General Reinsurance Corp. v. Missouri General Insurance Co.*, 458 F. Supp. 1, 5 (W.D. Mo. 1977), *aff'd.* 596 F.2d 330 (8th Cir. 1978).

[12] 40 U.S.C.A. § 270a (West 1986).

[13] 40 U.S.C.A. § 270b (West 1986).

[14] *See Ramsdell v. G.H. Coffey Co., Inc.*, 632 F.2d 162, 163 (1st Cir. 1980) (ordinarily, sovereign immunity bars attachment and garnishment of government funds and an unpaid subcontractor's remedy under sections 270a to 270d of this title is a payment bond). *See also U.S. ex rel. B's Co. v. Cleveland Elec. Co. of S.C.*, 373

(Footnote continued on following page)

However, under the Circuit Court's decision, the government will be able to side-step the Maryland insurance laws that would allow these laborers and materialmen the right to share equally with the government in the Eastern Indemnity assets.

III.

MANY OTHER CURRENT INSURER INSOLVENCY PROCEEDINGS, AS WELL AS FUTURE INSOLVENCIES, WILL BE DIRECTLY IMPACTED BY THE CIRCUIT COURT'S DECISION.

The Amici Curiae ask this Court to grant the Petitioner's petition for a writ of certiorari because of the effect that the final resolution of this case will have on a number of insurer insolvency proceedings currently underway as well as on future insolvencies which will undoubtedly occur.

As stated above, Maryland, like most states, has attempted to protect the policyholders of insolvent insurers by giving them a preference in the distribution of those insurers' assets. Giving the federal government a "superpriority" over all other policyholders will disrupt these priority systems and cast doubt upon the protection such statutes actually provide non-government policyholders.

In addition, the Fourth Circuit's decision will have a chilling effect on the conduct of insurer liquidation proceedings. With the Circuit Court's decision in hand, the federal government will continue to use 31 U.S.C.A. § 3713 (West Supp. 1988) to threaten state insurance liqui-

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[14] *continued*

F.2d 585, 589 (4th Cir. 1967) (suit under 270a to 270d of this title is the only remedy for an unpaid subcontractor on a government project; he has no claim or lien against the government).

dators with personal liability if its claims are not paid first. Such threats paralyze liquidators, who fearing personal liability, are hesitant to perform their statutory duties.[15] Moreover, if the federal government's intimidation tactics continue, they will no doubt discourage qualified persons from serving as liquidators.

IV.

THE CIRCUIT COURT'S DECISION FOR THE FIRST TIME CALLS INTO QUESTION WHETHER MANY OF THE MOST FUNDAMENTAL ASPECTS OF STATE INSURANCE REGULATION COME WITHIN THE "BUSINESS OF INSURANCE".

The rationale of the Fourth Circuit's decision places many basic and fundamental aspects of regulating and conducting the business of insurance outside the scope of the McCarran-Ferguson Act's protection. To accept the Circuit Court's view that the only activities which constitute the "business of insurance" (and are thus protected) are those directly connected to underwriting and policy issuance, leads to the conclusion that statutes regulating the formation and licensing of insurers do not regulate the "business of insurance." Yet this fundamental state regulatory power is unquestionably the type of insurance regulation that Congress intended to preserve for the states when it enacted the McCarran-Ferguson Act. Indeed, this Court itself has stated that state laws regulating the licensing

[15] *See* Affidavit of Fred Nepple dated 9-13-88 (Appendix 1), regarding the federal government's attempt to sue Nepple personally for satisfaction of an Internal Revenue claim against an insolvent insurer Nepple was liquidating. *See also* letter from Harry Eakin (liquidator of Allied Fidelity Insurance Co.) dated 1-13-88 (Appendix 2), informing all state insurance guaranty funds that their claims against Allied Fidelity's estate would not be paid until the issue of the federal government's alleged priority has been resolved.

of insurers are laws regulating the "business of insurance." *Securities and Exchange Commission v. National Securities, Inc.*, 393 U.S. at 460. *Cf. Robertson v. People of the State of California*, 328 U.S. 440 (1946).

Similarly, the Fourth Circuit's limited interpretation of this phrase would mean that an insurer's dealings with its policyholders (once a policy has been issued) do not constitute the "business of insurance" and that a state's unfair trade practice statutes which govern those dealings do not regulate the "business of insurance" and are not entitled to McCarran-Ferguson protection. *See* MD. ANN. CODE art. 48A, §§ 240A and 227 (1986 and 1988 respectively) (restricting an insurer's right to cancel policies after they have been written and prohibiting insurers from improperly inducing policyholders to cancel their policies).[16] Nothing in this Court's prior decisions interpreting the McCarran-Ferguson Act in its narrow anti-trust context, justifies or supports such a result.[17]

CONCLUSION

While this Court's caseload is severe, the instant case, presenting a pervasive insurance regulatory issue that will have an impact on the rights of insureds and claimants

[16] Ironically, the District Court which decided the case at bar has itself recognized that Maryland's unfair trade practice provisions regulate the "business of insurance" and are, in fact, entitled to the protection of the McCarran-Ferguson Act. *State of Maryland v. Blue Cross and Blue Shield*, 620 F. Supp. 907, 919-20 (D. Md. 1985). *See also Mathis v. Automobile Club Inter-Insurance Exchange*, 410 F. Supp. 1037, 1040 (W.D. Mo. 1976).

[17] *See supra* note 7 and accompanying text.

in all fifty states and the District of Columbia, merits this Court's review.

Respectfully submitted,

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APPENDICES

APPENDIX 1

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

JAMES A. GORDON, Special Deputy State Insurance Commissioner of Maryland and Receiver for Eastern Indemnity Company of Maryland,

Petitioner,

v.

UNITED STATES DEPARTMENT OF THE TREASURY, ET AL.,

Respondents.

AFFIDAVIT

STATE OF WISCONSIN
COUNTY OF DANE—ss.

Fred Nepple, being duly sworn upon oath, deposes and says:

1. Affiant is an attorney and employee of the Office of the Commissioner of Insurance of the State of Wisconsin, and at all times pertinent hereto was personally involved in the matters set forth below.

2. In 1975 Wisconsin Surety Corporation was an insurer domiciled in Wisconsin, and was in the business of selling surety bonds.

3. In April 1975 the Office of the Commissioner of Insurance of the State of Wisconsin placed Wisconsin Surety Corporation into liquidation, under the jurisdiction of the Liquidation Court, Dane County Circuit Court, Case No. 146-166.

4. The Court appointed the Wisconsin Commissioner of Insurance as Liquidator.

5. The United States of America, Internal Revenue Service, was one of the claimants in the liquidation estate, with certain specific claims seeking recovery under the provisions of surety bonds issued by the insolvent insurer, and with other specific claims seeking other types of recovery against the insolvent insurer.

6. In May 1984 the liquidation was completed and proceedings were terminated.

7. As of the termination date, the Liquidator pursuant to Wisconsin insurance liquidation law had paid none of the claims of the United States of America seeking recovery under the surety bond provisions.

8. In February 1985 representatives of the Office of the Commissioner of Insurance for the State of Wisconsin were notified that the United States of America was considering an action against the Commissioner, and that it asserted priority for all unpaid claims under Title 31, U.S.C. § 3713, and that it asserted personal liability against the Commissioner under Title 31, U.S.C. § 3713.

9. The aggregate amount of all claims and interest sought by the United States of America was approximately $200,000.

10. The liquidation proceedings were reopened, and a settlement was reached in 1987.

11. All facts set forth above in paragraphs 1-8 and 10 are filed with the Liquidation Court as a matter of public record in such Case No. 146-166.

/s/ FRED NEPPLE

Subscribed and sworn to
before me this 13th day
of September, 1988.

/s/ _____

Notary Public, Dane County
Wisconsin
My Commission: is permanent.

STATE OF WISCONSIN
CIRCUIT COURT
DANE COUNTY

In the Matter of the Liquidation of
WISCONSIN SURETY CORPORATION,
a Wisconsin Insurance Corporation.

REPORT ON CLAIM AND ORDER
CD #425A, B & C
CD #436A, B & C
Case No. 146-166

The Liquidator hereby reports to the Court regarding the above claim.

STATEMENTS BY CLAIMANT

The undersigned, being sworn, under the cooperation and perjury provisions of the Wisconsin Statutes states that:

1. The name and address of claimant is:
   United States
   Internal Revenue Service
   U.S. Department of Justice, Tax Division
   Washington, D.C. 20530

2. On the date of the insured event or on April 11, 1975 claimant was not [strike if appropriate] a resident of the State of Wisconsin (or a corporation organized under Wisconsin law).

[3. Claimant has not [strike if appropriate and furnish all pertinent details] received or acquired a preference, lien, conveyance, transfer, assignment or encumbrance voidable under Chapter 645, Wisconsin Statutes; and claimant does not [strike if appropriate and furnish all pertinent details] *hold security relating to this matter.]**

[4. Claimant has exerted and will continue to exert every reasonable effort to minimize any loss which is the subject of this claim, and to date has not [strike if appropriate and furnish all pertinent details] *received any payment regarding such loss; and claimant immediately will report to the Liquidator any such payment received subsequent to this date.]*

5. In consideration of the recommendation of the Liquidator of Wisconsin Surety Corporation regarding payment of part or all of the claim of the claimant bearing the above court docket number, the claimant hereby for himself, his heirs, executors, administrators and assigns, (or for itself, its successors and assigns) does remise, release and forever discharge such Liquidator and the Wisconsin Commissioner of Insurance each individually and in his official capacity, his heirs, executors, administrators, assigns and successors in office, and the estate of the Wisconsin Surety Corporation, from any and all right, cause of action, claim or demand of whatsoever kind, nature or description at law or in equity or created by statute which the claimant now has or which his heirs, executors, administrators or assigns (or its successors or assigns) can, shall, or may hereafter have.

6. Claimant hereby stipulates his approval of the determination by the Liquidator as set forth herein.

/s/ JEFFREY D. SNOW
Signature of person authorized
to act for claimant

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* Bracketed and italicized portions throughout were stricken in the original copy.

[On this ____ day of _____, 19____, before me personally appeared _____ to me personally known and known to be the same person described in and who executed the foregoing instrument and who duly acknowledged to me that he executed the same.]

On this 11th day of March, 1987, before me personally appeared Jeffrey D. Snow, to me known to be the person who executed the foregoing instrument, and to me known to be the attorney for said [Corporation], entity, and acknowledged that he executed the foregoing [as such officer as the deed of said Corporation] by its authority.

[Strike non-applicable paragraph]

(Notarization omitted in printing.)

STATEMENTS BY LIQUIDATOR

6. The claimant filed a written proof of claim which is deemed to have been timely filed in substantial compliance with Wis. Stats. §645.61 and which has received from this Court the above docket numbers.

7. The particulars of such claim and the amount claimed are as follows:

See attached.

8. The amount allowed in the determination by the Liquidator as set forth below does not exceed the amount of the bond under which this claim is made.

DETERMINATION BY LIQUIDATOR

WHEREFORE, on the basis of the foregoing and the records and data in the possession of the Liquidator and related investigation, the Liquidator hereby:

1) Recommends *[(reports)]* the allowance of the above-described claim in the amount of $28,102.33, with the amount allowed to be eligible for distribution to the claimant as follows: in Class 3 the amount of $24,128.53, *[in Class ____ the amount of $_____, in Class ____ the amount of $_____]* and in Class 5 the amount of $3,973.80, *[all pursuant to Wis. Stats. § 645-68 on a pro rata basis with all other approved claims in the above liquidation proceeding.]*

[2) Recommends the disallowance in full of the above-described claim.]

Dated: March 17th, 1987

LIQUIDATOR OF
WISCONSIN SURETY CORPORATION

By: /s/ CHRISTOPHER J. WILCOX

P.O. Address:

LaFollette, Sinykin, Anderson & Munson
Suite 300, 222 W. Washington Avenue
Madison, Wisconsin 53703

ORDER

Upon this record herein and the foregoing Report of the Liquidator and being fully advised in the premises, the Court by this Order hereby:

(1) Determines that the loss claim settlement as recommended for allowance is a loss for which Wisconsin Surety Corporation is liable, and accordingly approves such recommendation and allows payment of such loss claim settlement in the amount recommended by the Liquidator.

[(2) Approves such recommendation and disallows such claim in its entirety.]

[(3) Disapproves and modifies such recommendation as set forth in the attached Determination on Report or Claim.]

Distribution to the claimant of the amount allowed shall be according to the priorities recommended by the Liquidator.

[Portions of the amount allowed are eligible for distribution to the claimant in a class or classes lower in priority than Class 3. It is anticipated at this time that there will be insufficient assets to make any distribution to claimants in classes lower in priority than Class 3 and therefore that the above claimant will receive no distribution whatsoever regarding any portions eligible for distribution in Classes 4, 5, 6, 7, 8, 9, 10 and 11 inclusive, and that such claimant will receive no further notice regarding such portions.]

Dated: March 17th, 1987

BY THE COURT:

/s/ _____
Circuit Court, Branch 4
Dane County, State of Wisconsin

ATTACHMENT – C.D. 425A, B & C
and 436A, B & C

The claimant seeks recovery of $3,973.80, plus interest, for unpaid tax-related moneys alleged to be due directly from the insolvent insurance company, Wisconsin Surety Corporation. This claim is comprised of $3,281.74 (Claim 425C) for withholding and Federal Insurance Contribution Act taxes due from Wisconsin Surety Corporation; and of $692.06 (Claim 436C) for withholding due from Wisconsin Surety Corporation.

The claimant also seeks recovery of $50,854.14, plus interest, for actions taken by Wisconsin Surety Corporation under the provision of certain surety bonds issued by the insurer. This claim is comprised of $7,318.27 (Claim 425A) against Wisconsin Surety Corporation as surety for LTL Electrical Contractors, Inc.; $12,548.57 (Claim 425B) against Wisconsin Surety Corporation as surety for E. C. Construction Co., Inc.; $13,196.89 (Claim 436A) against Wisconsin Surety Corporation as surety for V & L Construction Co., Inc.; and $17,790.41 (Claim 436B) against Wisconsin Surety Corporation as surety for Vankeirsbelk Construction Company.

Claims 425A, 425B, 425C and 436B were disallowed by the Liquidator on June 18, 1980. The disallowance was mailed to the claimant, and no objection having been filed within 60 days, the Court ordered the claims disallowed on September 9, 1980. Claim 436A was disallowed by the Liquidator on June 18, 1980. The determination was mailed to the claimant, and no objection having been filed within 60 days, the Court disallowed the claim on September 12, 1980. Claim 436C was allowed in full by the Court on February 29, 1980, but the check issued to the claimant by the Liquidator in full payment has never been cashed and is now void.

On May 29, 1984 the liquidation proceedings were terminated. On or about February 6, 1985 representatives of the Office of the Commissioner of Insurance for the State of Wisconsin were notified that the claimant was

considering bringing an action against the Commissioner in federal court, asserting priority under Title 31, U.S.C. § 3713, and also asserting liability to the claimant under Title 31, U.S.C. § 3713. On February 18, 1987 the proceedings were reopened.

The claimant and the Liquidator have reached a formal settlement, by which the Liquidator has agreed to pay the claimant a total of $28,102.33, in return for a full release, in compromise of these disputed claims.

Accordingly, Claims 425A, 425B, 436A and 436B are allowed as class 3 claims, with the total amount for the four claims to be paid being $24,128.53; and Claims 425C and 436C are allowed in full as class 5 claims, with the aggregate amount to be paid being $3,973.80; for a total settlement to be paid forthwith to the claimant in the amount of $28,102.33.

Q:425.436

APPENDIX 2

Allied Fidelity
Insurance Co.

IN LIQUIDATION

TO: ALL STATE INSURANCE COMMISSIONERS, SUPERINTENDENTS AND DEPARTMENTS, ALL ANCILLARY RECEIVERS, AND ALL STATE INSURANCE GUARANTY FUNDS OR ASSOCIATIONS

FROM: INDIANA INSURANCE COMMISSIONER HARRY E. EAKIN, AS LIQUIDATOR OF ALLIED FIDELITY INSURANCE CO. ("AFIC")

DATE: JANUARY 13, 1988

RE: ALLEGED FEDERAL PRIORITY

Last September, the AFIC Liquidator sent to you an accounting, a duplicate copy of which is enclosed, which mentioned the uncertainty created by alleged federal priorities in the AFIC liquidation proceeding. See paragraphs 6 and 13 of the accounting. The uncertainty was heightened by the recent federal court decision in the Eastern Indemnity liquidation in Maryland. A copy of that decision is also enclosed.

While the AFIC Liquidator is still in the process of analyzing the thousands of claims received by the December 1 claim filing deadline, it looks as if the federal claims received will total in excess of $7 million. That being so, and until the AFIC Liquidator has had a chance to compile sufficient information to prepare a more complete report to the Court, each insurance department, ancillary receiver, and guaranty fund should make certain that no assets of AFIC

are used in a way that would arguably subject insurance departments, receivers or guaranty funds to the contention that the claimed federal priority has been violated. Obviously, departments, ancillary receivers or guaranty funds that are holding special deposits or other assets of AFIC need to be the most careful.